Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

HAROLD WARSHAY and DORIS WARSHAY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Did petitioners meet their burden of proof on the issue of whether high ranking officials of the Internal Revenue Service orally promised them immunity from civil prosecution for certain tax liabilities, thereby precluding entry of judgment against petitioners?

II. Does an oral promise by high ranking officials of the Internal Revenue Service not to prosecute petitioners for certain tax liabilities equitably estop the Internal Revenue Service from so prosecuting?

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HAROLD WARSHAY and DORIS WARSHAY,

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI

Petitioners Harold and Doris Warshay respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this action on February 7, 1995.

Opinions Below

The oral findings of fact and opinion and the subsequent Orders and Decision of the United States Tax Court finding that petitioners are liable to respondent for $116,094 in tax deficiencies are unreported and is set forth in Appendix B hereto. The Order of the Court of Appeals affirming the Tax Court's Decision is set forth in Appendix A hereto.

Jurisdictional Statement

The Order of the Court of Appeals was entered on February 7, 1995. This Petition for Writ of Certiorari was filed within ninety days of that date. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

Statutes Involved

This Petition does not directly involve any constitutional provisions, treaties, statutes, ordinances or regulations.

Statement of the Case

On or about September 30, 1991, the Commissioner of Internal Revenue sent petitioners Harold and Doris Warshay a notice of deficiency stating that they owed a total of $116,094.00 in deficiencies plus additions to tax for the years 1979 through 1982. The Warshays disagreed with this determination, and so on December 26, 1991 they filed with the United States Tax Court their petition for a redetermination of the deficiencies set forth in the notice.[1] The petition

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[1] The basis for jurisdiction in the Tax Court was 26 U.S.C. § 7442 and Rule 13 of the Tax Court Rules of Practice and Procedure.

did not contest the technical merits of the Commissioner's adjustments. It did, however, assert as a complete defense to those adjustments that, in exchange for Harold Warshay's cooperation with an ongoing criminal investigation of John Muir & Co., high ranking officials of the Internal Revenue Service ("IRS") had orally promised him that he and his wife would not be prosecuted for the deficiencies set forth in the notice. The Commissioner's answer denied that any such promise was ever made to Mr. Warshay, but admitted that he had rendered his assistance in connection with the investigation of John Muir & Co, where Mr. Warshay was then employed. On September 28, 1993, the parties filed a joint stipulation of facts which provided, inter alia, that:

12. The only issues in dispute are:

a. Whether oral promises were made by or on behalf of respondent to the effect that petitioners would be entitled to retain the tax benefits of their investment in AIP,[2] and;

b. If such promises were made, whether respondent should be precluded from disallowing said tax benefits in a statutory notice of deficiency.

The Tax Court, the Honorable David Laro presiding, then conducted a bench trial of these two issues on that same day. Mr. Warshay and his witness testified that high ranking officials of the IRS had promised him immunity from civil prosecution, while the Commissioner's witnesses testified that no such promise was ever made, or that they could not remember whether it had been made or not.

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[2] Harold Warshay had claimed deductions on the basis of his investment in the AIP (Arbitrage Investment Partnership), a tax shelter sponsored by John Muir & Co. The Commissioner disallowed these deductions in his notice of deficiency.

On October 6, 1993, Judge Laro rendered his oral findings of fact and opinion pursuant to Section 7459(b) of the Internal Revenue Code and Rule 152 of the Tax Court Rules of Practice and Procedure. In his findings of fact, Judge Laro found that Mr. Warshay assisted the IRS for approximately four years in its investigation of John Muir & Co. In his opinion, however, Judge Laro stated that Mr. Warshay had failed to establish the existence of an oral agreement between himself and high officials of the IRS that would protect the Warshays from civil tax liability. Judge Laro accordingly sustained the Commissioner's determination in full.

Because he found that Mr. Warshay had not proven the existence of an agreement, Judge Laro did not determine whether such a promise, if it had been made, would be binding upon the Commissioner. It is

significant, however, that Judge Laro found that Mr. Warshay had established that he cooperated with the IRS's investigation and that he suffered detriment, one of the elements of the equitable estoppel defense petitioners raised. In light of this finding of detriment, it is inexplicable that Judge Laro did not also find that Mr. Warshay had relied upon the IRS's promise. No other reason could be inferred for Mr. Warshay's cooperation -- to the detriment of both his person and his career -- with the Government's investigation.

Pursuant to his opinion of October 6, 1993, Judge Laro ordered that the Warshays were liable for the deficiencies set forth in the Commissioner's notice of deficiency. This last order was entered on December 8, 1993. The Warshays appealed this order to the United States Court of Appeals for the Second Circuit.

On February 7, 1995, the Court of Appeals entered its Order affirming Judge Laro's decision.

The gravamen of the Warshays' petition for a writ of certiorari is that Judge Laro was clearly wrong to credit the testimony of the Commissioners' witnesses, who were unable to remember virtually anything about Mr. Warshay's extensive cooperation with the IRS investigation of John Muir & Co., that there was no promise to immunize the Warshays from civil tax liability. These witnesses' inexplicable failure to recall the material facts relating to a major investigation by the IRS, the Securities and Exchange Commission ("SEC") and the United States Attorney for the Southern District of New York should have led Judge Laro to discount their testimony. Mr. Warshay and his witness, in contrast, clearly recalled their participation in the John

Muir & Co. investigation, and should have been believed when they testified that the Warshays were promised civil tax immunity. In affirming the Tax Court's erroneous decision, the Court of Appeals also committed reversible error.

That there was an investigation of John Muir & Co., despite the Commissioner's witnesses' inability to recall it, is not subject to doubt. Peter Quigley, then an investigator for the SEC on special assignment to the United States Attorney's office, testified that he was assigned to the investigation in 1981, and that Mr. Warshay, together with Hans Reinisch, also an employee of John Muir & Co., had instigated the investigation. Mr. Quigley met with Messrs. Warshay and Reinisch on at least ten different occasions. Linda Cassano, then special counsel to the SEC, confirmed that Messrs. Warshay and Reinisch provided the government with

information relevant to its investigation of John Muir & Co. Mark Sirkin, a special agent with the IRS Criminal Investigation Division, testified that the IRS was involved in the investigation.

On the basis of this and other testimony, Judge Laro expressly stated in his findings of fact that:

> Reinisch contacted the Internal Revenue Service (IRS). Reinisch and Warshay assisted the SEC and IRS for approximately four years during which time the Office of the United States Attorney also participated in the investigation.

and that:

> At various times [Warshay] and Reinisch met with Linda Cassano, Special Counsel to the SEC; Donald Malawsky, Deputy Regional Administrator of the SEC; Peter Quigley, an SEC investigator; Pamela Chepiga of the United States Attorney's Office; Mark Sirkin, a special agent with the IRS Criminal Investigation Division; Daniel Kornblatt, an IRS agent, and others.

Mr. Warshay stated under oath that, in addition to the persons cited by Judge Laro, he also met with Charles H. Bren-

nan, then the IRS District Director of the Manhattan District, and Raymond Turner, Assistant Regional Commissioner of Criminal Investigation of the IRS for the North Atlantic Region. It was at their first meeting, which Mr. Reinisch also attended, that Messrs Brennan and Turner promised Mr. Warshay that no harm whatsoever would come to Mr. Warshay if he assisted them in their investigation of John Muir & Co., and that he would not be exposed or lose any of the tax benefits of his investment in the AIP. Mr. Reinisch confirmed that the meeting took place, and that Mr. Warshay received from Messrs. Brennan and Turner the assurances he requested.

There was a second meeting between Messrs. Warshay, Reinisch, Brennan and Turner, and again Messrs. Brennan and Turner assured Mr. Warshay that "a deal is a deal" and no harm would come to him

as a result of his cooperation with the IRS's investigation of John Muir & Co. They gave him no reason to believe that they were unauthorized to make the promises they had made. Mr. Warshay would not have cooperated with the investigation if he had thought they were unauthorized to offer him immunity from civil tax liability. Mr. Reinisch also confirms that this meeting took place and that Messrs. Brennan and Turner were present.

In view of the magnitude of the John Muir & Co. investigation, and the fact that Messrs. Reinisch and Warshay instigated and assisted it for four years, it would be incredible for anyone involved in that investigation to claim that he could not recall the crucial role they played, even ten years after the fact. Nevertheless, Mr. Brennan testified that he had never even met Messrs. Reinisch or

Warshay until the day of the hearing on September 28, 1993. Mr. Turner testified to the same effect.

Even more incredible, however, is the fact that none of the Commissioner's witnesses could locate any mention of Messrs. Warshay's or Reinisch's names in the IRS files relating to the John Muir & Co. investigation. Mr. Sirkin, for example, testified that he reviewed all of the IRS files relating to the investigation, but could find no reference to Harold Warshay. In fact, his search of the IRS's computerized files revealed that there was no record of any documents whatsoever relating to the John Muir & Co. investigation. This revelation proved so embarrassing to the Commissioner that it stipulated in open court that "[a]n examination of the IRS files will reveal documents relating to the investigation of John Muir & Company." Mr.

Brennan testified that he did not even bother to inquire whether or not there was an IRS file relating to the John Muir & Co. investigation. Mr. Turner conducted only a perfunctory check by telephone, and was told that "nobody knew anything about that case." It boggles the mind that the IRS, an organization that routinely tracks every investigation by computer,[3] could have permitted all traces of the John Muir & Co. case to vanish into a black hole.

Yet that case <u>was</u> prosecuted by the IRS, and it ultimately resulted in the criminal indictment of Daniel Lanahan, a principal of John Muir & Co. Mr. Warshay, however, reaped no reward for his role in the IRS's success. On the contrary, he was subjected to physical dan-

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[3] Mr. Sirkin, for example, testified that "[a]ny time a particular division of the IRS is working on any particular entity, the computer keeps track of it and a code is put on there."

ger for which Linda Cassano offered bodyguard protection. After his cooperation with the investigation became generally known in the securities industry, he faced extreme difficulty in finding employment, and in fact did not find a salaried position until 1992. Judge Laro expressly noted Mr. Warshay's travails when he noted in his October 6, 1992 opinion that Mr. Warshay had established detriment.

Under these circumstances, it would be unconscionable for the IRS now to repudiate the promise its high ranking officials made to Mr. Warshay when they needed his assistance. Allowing the IRS to evade its obligations would have a chilling effect on the willingness of confidential informants to come forward in connection with any future investigation by the federal government. It would also be egregiously unfair to Mr. Warshay.

Argument

This Petition should be granted because it affords the Court an opportunity to clarify previous decisions that have resulted in conflicting decisions in the United States Courts of Appeals.

The questions presented for review herein boil down to the issue of when the United States government should be equitably estopped from enforcing otherwise valid statutes or regulations. This Court has previously recognized that

> [t]he language in our decisions has spawned numerous claims for equitable estoppel in the lower courts. As Justice Marshall stated in dissent in [Schweiker v. Hansen, 450 U.S. 785, 792 (1981)], "[t]he question of when the Government may be equitably estopped has divided the distinguished panel of the Court of Appeals in this case, has received inconsistent treatment from other Courts of Appeals, and has been the subject of considerable ferment."

Office of Personnel Management v. Richmond, 496 U.S. 414, 422 (1990). The Richmond Court further noted that "feder-

al courts have continued to accept estoppel claims under a variety of rationales and analyses," and that there is "a good indication that our approach to these cases has provided inadequate guidance or the federal courts and served only to invite and prolong needless litigation." Id. at 422-423. The Richmond Court nevertheless decided to "leave for another day whether an estoppel claim could ever succeed against the Government." Id. at 423.

In this case, petitioner Harold Warshay gave valuable assistance to the IRS in connection with a major criminal investigation. He did so at considerable risk to his livelihood and indeed his person, for high-ranking officers of the IRS had assured him that, in view of his cooperation, he would not suffer any adverse tax consequences. Now, however, the IRS has reneged on its representatives' promises

and threatens to hold petitioners liable for taxes they were assured they would not owe. Petitioners respectfully submit that today is the day for this Court to assert that, under the circumstances of this case, the Government can be equitably estopped.

I. THE TAX COURT WRONGLY CONCLUDED THAT HAROLD WARSHAY FAILED TO MEET THE BURDEN OF PROOF THAT HE WAS PROMISED IMMUNITY FROM CIVIL TAX LIABILITY.

In his testimony before the Tax Court, Harold Warshay stated under oath that in 1980 Charles H. Brennan, then District Director of the Manhattan District, and Raymond Turner, Assistant Regional Commissioner of Criminal Investigation of the Internal Revenue Service for the North Atlantic Region, promised him that he would suffer no adverse civil tax consequences if he would assist the IRS in its investigation of John Muir & Co.

Mr. Reinisch confirms that the meeting took place, and that Mr. Warshay received from Messrs. Brennan and Turner the assurances he requested.

There was a second meeting between Messrs. Warshay, Reinisch, Brennan and Turner, and again Messrs. Brennan and Turner assured Mr. Warshay that "a deal is a deal" and no harm would come to him as a result of his cooperation with the IRS's investigation of John Muir & Co. They gave him no reason to believe that they were unauthorized to make the promises they had made. Mr Reinisch also confirms that this meeting took place and that Messrs. Brennan and Turner were present.

Notwithstanding this unambiguous and corroborated testimony, Judge Laro found in his October 6, 1993 bench opinion that Mr. Warshay had "failed to establish the existence of an oral agreement between

[Mr. Warshay] and either, Brennan, [sic] Turner or both, that would protect [the Warshays] from civil tax liability." Judge Laro also found, however, that Mr. Warshay had established that he cooperated with the IRS's investigation and that he suffered detriment, one of the elements of the equitable estoppel defense petitioners raised. In light of this finding, it is inexplicable that Judge Laro did not also find that Mr. Warshay's cooperation with the IRS's investigation and the resulting detriment suffered by Mr. Warshay necessarily followed from Mr. Warshay's reliance upon the IRS's promise. No other reason could be inferred for Mr. Warshay's cooperation -- to the detriment of both his person and his career -- with the Government's investigation. Furthermore, the testimony of the Commissioner's witnesses that Mr. Warshay had not been involved in the

IRS's investigation, especially in light of Judge Laro's findings to the contrary, was so incredible as to boggle the mind. Judge Laro was therefore clearly in error, and under the applicable standard of review should have been reversed.

The John Muir & Co. investigation was a major one, involving the IRS, the SEC and the United States Attorney's office. As Judge Laro found, Messrs. Reinisch and Warshay assisted that investigation for a period of four years. It would therefore be incredible if anyone involved in that investigation claimed that he could not recall the crucial role they played, even ten years after the fact. Nevertheless, Mr. Brennan testified that he had never even met Messrs. Reinisch or Warshay until the day of the hearing on September 28, 1993. Mr. Turner testified to the same effect.

Even more incredible, however, is the fact that none of the Commissioner's witnesses could locate any mention of Messrs. Warshay's or Reinisch's names in the IRS files relating to the John Muir & Co. investigation. Mr. Sirkin, for example, testified that he reviewed all of the IRS files relating to the investigation, but could find no reference to Harold Warshay. In fact, his search of the IRS's computerized files revealed that there was no record of any documents whatsoever relating to the John Muir & Co. investigation. This revelation proved so embarrassing to the Commissioner that it stipulated in open court that "[a]n examination of the IRS files will reveal documents relating to the investigation of John Muir & Company." Mr. Brennan testified that he did not even bother to inquire whether or not there was an IRS file relating to the John Muir

& Co. investigation. Mr. Turner conducted only a perfunctory check by telephone, and was told that "nobody knew anything about that case." It stretches credulity to the breaking point that the IRS, an organization that routinely tracks every investigation by computer,[4] could have permitted all traces of the John Muir & Co. case to vanish into a black hole.

Yet there was an investigation of John Muir & Co., despite the Commissioner's witnesses' inability to recall it. Peter Quigley, then an investigator for the SEC on special assignment to the United States Attorney's office, testified that he was assigned to the investigation in 1981, and that Mr. Warshay, together with Hans Reinisch, also an employee of John

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[4] Mr. Sirkin, e.g., testified that "[a]ny time a particular division of the IRS is working on any particular entity, the computer keeps track of it and a code is put on there."

Muir & Co., had instigated the investigation. Mr. Quigley met with Messrs. Warshay and Reinisch on at least ten different occasions. Linda Cassano, then special counsel to the SEC, confirmed that Messrs. Warshay and Reinisch provided the government with information relevant to its investigation of John Muir & Co. Mark Sirkin, a special agent with the IRS Criminal Investigation Division, testified that the IRS was involved in the investigation. On the basis of this and other testimony, Judge Laro found that:

> At various times [Warshay] and Reinisch met with Linda Cassano, Special Counsel to the SEC; Donald Malawsky, Deputy Regional Administrator of the SEC; Peter Quigley, an SEC investigator; Pamela Chepiga of the United States Attorney's Office; Mark Sirkin, a special agent with the IRS Criminal Investigation Division; Daniel Kornblatt, an IRS agent, and others.

There can be no even remotely plausible explanation for the discrepancy between the testimony of employees of the IRS,

who to a man could not remember anything about the John Muir & Co. investigation, and the testimony of representatives from the SEC and the United States Attorney's office, who did recall the investigation. The testimony of Harold Warshay and Hans Reinisch, a disinterested third party, is clear and unambiguous. In 1980 they met with Messrs. Brennan and Turner.[5] Messrs. Brennan and Turner promised Mr. Warshay he would not be held liable for any tax liabilities stemming from his investment in the AIP. This is the testimony Judge Laro should have credited, and not the wholly incredible testimony of witnesses who could not recall whether the IRS investigation of John Muir & Co. was even conducted.

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[5] How either Mr. Warshay or Mr. Reinisch could have known of Messrs. Brennan and Turner's names, let alone their positions in the IRS hierarchy, is inexplicable unless they did meet at some time.

Judge Laro apparently did credit Mr. Warshay's and other witnesses' testimony that Mr. Warshay cooperated with the IRS's investigation, for he expressly found this to be the case. He also found that Mr. Warshay had suffered detriment. It necessarily follows that Mr. Warshay's testimony as to the existence of his agreement with the IRS was more probably true than not, for nothing but such an agreement would explain why Mr. Warshay undertook to assist the IRS despite the detriment Judge Laro found he suffered. Judge Laro thus ignored the logical implications of his own findings of fact and committed reversible error when he decided that Mr. Warshay had not met his burden of proof as to the agreement's existence.

II. THE COMMISSIONER IS EQUITABLY ESTOPPED FROM PROSECUTING THE WARSHAYS FOR THE TAX LIABILITIES HERE AT ISSUE.

Charles H. Brennan and Raymond Turner were officials in the IRS's highest echelons. Their promise to Harold Warshay not to prosecute him for tax liabilities stemming from his investment in the AIP, coupled with Harold Warshay's actual cooperation with the IRS's investigation of John Muir & Co., precludes the Commissioner from collecting those liabilities. The Tax Court made no binding determination of this issue.

The doctrine of equitable estoppel precludes the Commissioner from repudiating a promise such as the one Messrs. Brennan and Turner made. Indeed, courts have specifically held that "[w]ith respect to the IRS, equitable estoppel is appropriate under certain limited circumstances." Tonkonogy v. United States, 417 F. Supp. 78, 79 (S.D.N.Y. 1976); see

also, Schuster v. Commissioner, 312 F.2d 311, 317 (9th Cir. 1962); Simmons v. United States, 308 F.2d 938, 945 (5th Cir. 1962) ("It is well settled that the doctrine of equitable estoppel ... may be invoked against the United States in cases involving internal revenue taxation"). This Court has never held otherwise; thus, in Botany Worsted Mills v. United States, 278 U.S. 282, 289 (1929), the Court held an informal agreement by the Bureau of Internal Revenue to be non-binding "without determining whether such an agreement, though not binding in itself, may when executed become, under some circumstances, binding on the parties by estoppel." See also Hansen, 450 U.S. at 789 (with reference to welfare benefits, "[t]his Court has never decided what type of conduct by a Government employee will estop the Government from insisting upon compliance with valid

regulations governing the distribution of" such benefits).

The "limited circumstances" under which equitable estoppel applies to the IRS are set forth in Tonkonogy, 417 F. Supp. at 79:

> (1) a misrepresentation by an agent of the United States acting within the apparent scope of his duties; (2) the absence of contrary knowledge by the taxpayer in circumstances where he may reasonably act in reliance; (3) actual reliance; (4) detriment; and (5) a factual context in which the absence of equitable relief would be unconscionable.

Citing Lynn & Gerson, Quasi-Estoppel and Abuse of Discretion as Applied Against the United States in Federal Tax Controversies, 19 Tax L. Rev. 487, 488-489 (1964); Lignos v. United States, 439 F.2d 1369 (2d Cir. 1970) (unresolved issue of whether there was false representation or wrongful misleading silence by taxpayer precluded summary judgment in his favor).

These circumstances are clearly present in the case at bar. First, District Director (now Regional Commissioner) Brennan and Assistant Regional Commissioner Turner misrepresented to Harold Warshay that he would not be liable for certain adverse tax consequences if he assisted them in their investigations, even though they provided him with no written statement to that effect. Second, Mr. Warshay (who was not represented by counsel in his dealings with the IRS) had no knowledge that said officers could not compromise his civil tax liability orally, nor did Messrs. Brennan and Turner ever indicate that they lacked such authority. Third, Mr. Warshay relied upon said officers' misrepresentations when he agreed to assist them in the IRS's investigation of John Muir & Co. He would not have cooperated with the investigation if he had not thought they

were affording him immunity from civil tax liability. Fourth, as Judge Laro found, this reliance was detrimental, for in cooperating with the IRS's investigation, Harold Warshay exposed himself to personal physical harm and damage to his business reputation.

Fifth, and most important, the factual context of this case is such that it would be unconscionable to deny petitioners equitable relief. In view of the personal risk that Harold Warshay undertook when he assisted the Internal Revenue Service in a major criminal investigation, and the loss of business reputation suffered by him, it would be profoundly unfair to permit respondent to repudiate its senior officers' promises. As the Tonkonogy court observed,

> as to a taxpayer who relies upon [an IRS agent's] statements to his detriment at a time of great personal trauma and concern, that agent will be found to be acting within the

> apparent scope of his authority. Anything to the contrary would, in my opinion, be '... hardly worthy of our great government.'

Citing Brandt v. Hickel, 427 F.2d 53, 57 (9th Cir. 1970).

Finally, public policy considerations also support granting the Warshays the relief of equitable estoppel. The factual circumstances of this case are exceptional, and will not often apply to deprive the United States of tax revenue to which it otherwise would be entitled. The IRS and other federal agencies, however, would be hard pressed to find anyone willing to cooperate with their investigations if they could repudiate their senior officers' promises as summarily as the IRS seeks to repudiate them here.

Cases where the courts declined to apply principles of equitable estoppel are inapposite to the case under review.

They can be easily distinguished on their facts. In Rudisill v. Commissioner, T.C. Memo. 1992-388, for example, it was merely a desk clerk who allegedly advised the petitioner to "go home and forget about" refiling his taxes. Similarly, in Galucci v. Commissioner, T.C. Memo. 1992-435, and Wagner v. Commissioner, T.C. Memo. 1990-443, it was agents of the United States Attorney's office who, notwithstanding their alleged oral agreements with the respective petitioners, had specifically advised the petitioners' attorneys that they had no authority to compromise civil tax liabilities. In the case at bar, however, it was the District Director, not a low-ranking subordinate or representative of another agency, who promised petitioner the IRS would not disallow certain benefits. It is undisputed that Mr. Brennan had sufficient authority to enter into closing and com-

promise agreements under Sections 7121 and 7122, respectively, of the Internal Revenue Code.

Conclusion

For all of the reasons set forth above, the writ of certiorari should be granted.

Dated: New York, New York
May 1, 1995

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